Case Study One Assignment

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1. What were in your opinion the causes of financial distress at Flow Management? Could the financial distress have been prevented? If yes, explain how. If no, why not?

Cause of financial distress:

1. Poor management. There are a few faults in the finance of Flow Management which leads to the beginning of the whole story. For example, the 2013 loss is the result of basic principles used in the cost price calculation deviating from reality because they failed to periodically check the real cots against the results of the cost price calculation. If there is substantial errors in the financial figures you cannot expect the management is effective.
2. Over confidence and arrogance. The financing working capital at the main subsidiary FMW BV is €360 million and loans from four banks ag FMW BV amount to €55 million on 16 November 2013. In contrast, the net profit of 2012 and 2013 is negative. This means that Flow Management was not able to pay the interest of the loans. This is partly the result of the company’s fantasy of expansion.

There are chances to prevent the financial distress if some measures can be taken in a timely manner. The most important thing is to enhance the ability and professionalism of the finance and accounting team. If the top management can have the correct financial result and know the real financial status of the company they will likely have time to take counter solutions. From the business perspective, the management may consider changing the aggressive approach which leads to the large amount of loans.

1. What are the general advantages and disadvantages of an out-of-court restructuring (workout) as compared to a formal bankruptcy procedure? More specific, what are the advantages versus disadvantages in your country?

Advantages and disvantages of workout (specifically in China)

1. Flexibility.

Advantage: Workout depends on the negotiation amongst stakeholders and the tailor-make solutions can be elaborated and deviation from legal compulsory provisions. There is no law regarding the out-of-court negotiation in China. Therefore, the laws such as the Civil Code which applies to the whole commercial activities applies in restructuring as well.

Disadvantage: Workout needs the consensus of all stakeholders. In the process of negotiation, the stakeholders are not obliged to listen the any person’s arrangement or instruction. There is possibility that the inorganized groups of stakeholders cannot reach consensus of any workout. From this perspective, workout has risk of no effect.

1. Silence.

Advantage: The negotiation process can be kept confidential which will not attract social attraction and media concern. If the company is put under the spot light, it is not good for the company focus on how to get out of the financial distress.

Disadvantage: Silence means the core information are held confidential in part of stakeholders rather than all stakeholders. In some sense, this is not just and equal.

1. Control.

Advantage: The management can continue to fully run the company independently which will save costs because in in principle during the negotiation the creditors will not interfere with the daily business of the company.

Disadvantage: The continued management control may make the management to be inactive in discharging their duties. It may be even worse if management make use of the silent period to escape from the company or country.

1. Were the turnaround /reorganization approaches as presented in the reading material applied in this case? If yes, explain in what way. If no, detail what in your opinion should have been done differently.

Some turnaround approaches as presented in the reading material were applied in this case.

Open and active communication

When the management realized there was financial situation for the company, the board of FM Holding proactively invited the four banks for a meeting.

Breathing space in Phase I Stabilizing

The first plan presented and taken by the management was price increases and spending cuts. Four banks concluded not to panic, and decided that action must be taken jointly and in a controlled manner pending the final report from the consultancy agency.

Change of management

In the middle of April 2014 the CEO of FM Holding BV is replaced in order to have more smooth communication with creditors.

1. Banks C and D seem to frustrate the process at a certain point. What could have been the (rational and/or opportunistic) reason(s) for them to behave like that? What would you have done in that situation in your role as advisor of the other two banks?

Banks C and D are all of sudden not cooperating when in mid February 2014 it is clear that the process to come to a standstill agreement passed off with difficulty. At the end of June 2014, banks C and D threaten to cancel the credit which seems to be a signal to the company to hurry up.

The first possible reasons for banks C and D to behave like that is their worry about what will happen if a standstill agreement ultimately passes off and they will likely lose in the starting line in tracing the debtor. Another reason is somewhat opportunistic. It is possible that they hope to take advantage of the time when other banks refrain from taking steps to enforce their claims and try to improve their individual positions.

If I act as advisor of banks A and B, I would advise banks A and B to have open and frank discussion with banks A and B because any individual action against the debtor will prejudice other creditors and the themselves as well. The final result is no winner at all. Alternatively, just as banks A and B did, I would advise to explore the possibility of buying out C and D’s loan with discount.

1. Which of the eight principles of the ‘Statement of Principles for a Global Approach to Multi-Creditor Workouts II’ can be found in the workout process of Flow Management (explicit or implicit)?

First Principle: All four banks realize in January 2014 that a joint approach is desired and that a standstill agreement must soon be signed by the banks. In the middle of August 2014, the 120-days standstill agreement is signed.

Second Principle: When there is friction among the banks, and among banks and shareholders about cooperation in finding a solution and banks C and D are not cooperating, banks A and B try to find solution for the aim of a standstill agreement.

Third Principle: After the standstill agreement is signed the stakeholders manage to sign a restructuring agreement on 4 July 2015.

Fourth Principle: The creditors act as a whole and decide to pursue a standstill agreement in the shore term in August 2014.

1. Suppose it is not possible to convince other creditors to adopt the Statement of Principles in a given situation, are there any other possibilities for “soft law” to use (perhaps specifically in your country/region? If yes, explain in what way. If not, do you see any alternative (informal) possibilities?

If it is not possible to convince other creditors to adopt the Statement of Principles in this situation, in China, the debtor can only negotiate with every creditor individually. Beside this, there is no other soft law to push all creditors around the table.

1. Explain in detail the essence and result of the restructuring agreement as signed on the 4th of July 2015.

The essence of the restructuring agreement is to transfer the shares of a shell subsidiary which will receive all operating companies of Flow Management Holding BV to the consortium of banks while the debt and loan in Flow Management Work BV is cancelled. After that the banks can sell their shares in due course.

As a result of this restricting, the foundation is laid for selling the shell company ie. Flow Management II in a going concern situation.

1. Which (potential) legal and/or non-legal cross-border issues—if any—do you recognize in the Flow Management restructuring process?

First, a few jurisdictions in which the holding company, its shareholder company, and its six subsidiaries are based are involved. Therefore, it is an issue if one restructuring agreement can apply in all these jurisdictions. Second, it is possible that for bank creditors lies in different jurisdictions. Therefore, it is an issue how creditors from different countries can work on one restructuring agreement.

1. In October 2014 four scenarios have been drawn up. Why was or wasn’t calling for a moratorium a good option given the situation at that time?

In four scenarios drawn up in October 2014, a moratorium is regarded as the last option after refinancing, sale and debt equity swap. Indeed, under Bankruptcy Law of China, when the court accepts the filing of bankruptcy petition, the moratorium will automatically occur. In other words, it is not an innovation in the standstill period to regard moratorium as a good option because the law has provided it as the last resort when restructuring fails.